

July 21, 2015

VIA E-MAIL: e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Securities Administration
(Attention: D-11712, D-11327, D-11713)
U.S. Department of Labor
200 Constitution Avenue, N.W.
Suite 400
Washington, DC 20210

Re: Proposed Conflict of Interest Rule and Related Proposals (RIN-1210-AB32)

Ladies and Gentlemen:

This letter is submitted in response to the request by the Department of Labor (the "Department") for comments on the various regulations published on April 20, 2015, regarding the definition of the term "fiduciary"; conflict of interest rule; and retirement investment advice (collectively, the "Proposed Rules").

The focus of this comment letter is limited to unit investment trusts ("UITs") and the potential impact of the Proposed Rules on the ability to sell UITs to plans, participant and beneficiary accounts, and IRAs. Our firm has served as legal counsel to numerous current and former sponsors of UITs over the last 30 years. We note an absence of any specific references to UITs in all of the Proposed Rules which were published in the Federal Register on April 20, 2015. We respectfully submit that this omission may indicate that the Department is not aware of the billions of dollars of assets represented by UITs which have historically been held in various retirement accounts for decades. Further, we would like to note certain characteristics of UITs and, in particular, the methods by which their units are distributed to the public. In summary, we request that the Department make revisions to the Proposed Rules so that UITs, whose units, which although sold on a principal basis, offer the protection of being redeemable securities that must be priced at net asset value, can continue to be held in such retirement accounts.

Unit Investment Trusts are included in the Definition of "Asset" in Section VIII(c) of the Proposed Best Interest Contract Exemption

Section 4 of the Investment Company Act of 1940, as amended (the "1940 Act"), classifies investment companies into three principal classes, "Face-amount certificate company", "Unit investment trust" and "Management company," with management companies divided in Section 5 of the 1940 Act into either an "Open-end company" (commonly referred to as "mutual funds") or a "Closed-end company." The definition of "Asset" in Section VIII (c) of the Proposed Best Interest Contract Exemption¹ includes... "shares or interests in registered investment companies..." which would include all unit investment trusts. However, The Best Interest Contract Exemption also provides in Section I(c) that this exemption does not apply if "(2) The compensation is received as a result of a transaction in which the Adviser is acting on behalf of its own account or the account of the Financial Institution, or the account of a person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Financial Institution (i.e., a principal transaction)."² This is an issue for UITs, the units of which are technically not normally sold on an "agency" basis but rather are distributed on an underwritten basis.

¹ ZRIN 1210-ZA25; 80 Fed. Reg. at 21987 (April 20, 2015).

² 80 Fed. Reg. at 21984.

Units of Unit Investment Trusts are Sold on a Principal Basis, in Particular in "Riskless Principal Transactions"

UITs can be divided into "equity" and "fixed income" trusts. According to the Investment Company Institute's 2015 Investment Company Fact Book, equity UITs represented 85 percent of the assets in the roughly \$101 billion of assets held in total by UITs at the end of 2014. Fixed income UITs usually involve a fixed number of units, which are sold by the sponsor as exclusive principal underwriter, often through an underwriting syndicate with other broker-dealer firms pursuant to an underwriting agreement. Equity UITs typically create units based upon investor demand during the offering period of each individual series. The sponsor of the equity UIT, also acting as the exclusive principal underwriter, either enters into selling agreements designated as "dealer agreements" with retail broker-dealers or distributes units through its affiliated broker-dealers. These transactions in equity UITs would "most accurately described as a 'riskless principal' transaction in which the fiduciary that is providing investment advice purchases shares on its own account purposes of covering a purchase order previously received from a plan or IRA and then sells the shares to the plan or IRA to satisfy the order."³ Whichever type of UIT or method of distribution, it is important to note that, like mutual funds, all units of UITs are required to be sold at net asset value (NAV) and the broker dealer receives a fixed sales commission or concession, as specified in the UIT prospectus, rather than a negotiated dealer mark-up.

Unit Investment Trusts Share Many of the Characteristics of Mutual Funds

In the Proposed Rules, the Department describes at some length the characteristics of Mutual Funds, in particular the Proposed Best Interest Contract Exemption, in connection with the possible streamlined exemption for high quality, low fee products, the Department, states that "the products must have fee structures that are transparent, publicly available, and capable of being compared reliably."⁴ Unit Investment Trusts are required to be sold by means of a delivered prospectus which includes full disclosure of the UIT's fees structure as required by the 1940 Act and FINRA rules. In fact, equity UITs which commonly feature deferred sales charges, are required as a condition of SEC exemptive orders to include fee and expense tables modeled on the requirements of N-1A for mutual funds. As mentioned previously, UITs are required to be sold at a price based upon a current public offering price. As defined in Section 4(c) of the 1940 Act, UITs may issue "only redeemable securities, each of which represents an undivided interest in a unit of specified securities." As a result, units are not only liquid but the provisions of Section 22, Rule 22c-1 and Rule 22(d) of the 1940 Act concerning the redeemable securities of registered investment companies, each apply to unit investment trusts as well as to mutual funds. As a result, units must be sold, redeemed, or repurchased at a price based on current net asset value of the UIT portfolio. Any reductions in sales charges are required to be disclosed. FINRA rules require the full disclosure of any sales commissions or concessions paid to various broker dealers also must be disclosed in the UIT prospectus. In addition, investors can easily obtain UIT price quotes from brokerage or investment firms and investment company websites.

Characteristics of Unit Investment Trusts which are Different from Mutual Funds

There are a few additional characteristics of UITs which we believe may be relevant to the Department in determining possible revisions or clarifications to the Proposed Rules as they pertain to UITs.

The prospectuses for UITs are not only transparent with respect to fees and expenses, but also with respect to the portfolio itself since UITs are required to invest in "specified securities." The portfolios

³ ZRIN 1216-ZA25; 80 Fed. Reg. at 22025 (April 20, 2015).

⁴ 80 Fed. Reg. at 21979.

are professionally selected to meet stated investment goals, such as growth, income or capital appreciation and remain relatively fixed. While not actively managed, they are supervised and securities may be sold only in very limited circumstances such as serious credit factors. In addition, unlike the ongoing life of mutual funds, UITs have a predetermined termination date, with most equity UITs lasting only a year or two. As a result of these features, UITs may be particularly suited to filling the specific investment needs and time horizons of a retirement investor.

With respect to fees and expenses, the Department should be aware that UITs:

- do not have a board of directors and consequently do not have quarterly meetings, a UIT's assets are held in trust for the benefit of the investors by a trustee, and operational matters are for the most part handled by the trustee with assistance by the sponsor;
- may not issue multiple classes of shares or units (Rule 18f-3 of the 1940 Act is applicable only to registered open-end management companies);
- are not permitted to pay ongoing 12b-1 distribution fees (Rule 12b-1 of the 1940 Act also is applicable only to registered open-end management companies); and
- while UITs may pay modest portfolio supervisory fees, they are not actively managed and as a result, do not pay management, advisory or sub-advisory fees.

Suggested Revisions or Clarifications to the Department's Proposed Regulations with Respect to Unit Investment Trusts

At a minimum, specific relief is necessary so that units of UITs, which are an "Asset" as defined in the Proposed Best Interest Contract Exemption, can be sold as they currently are, in principal transactions. In some cases, this may merely be a matter of clarification of definition terms. For example PTE 84-24, allows the receipt of a "Mutual Fund Commission" by "a Principal Underwriter for an investment company registered under the Investment Company Act of 1940 (an investment company)."⁵ An "investment company" would include UITs for purposes of this PTE. All or some of these suggestions may be necessary.

1. Proposed Best Interest Contract Exemption:

Provide a regulatory carve out from the exclusion in Section 1(c) on principal transactions for the sale of the units of unit investment trusts. As we described previously, all of such sales include the pricing safeguards required by the 1940 Act with respect to the sale of redeemable securities of a registered investment company and do not raise the types of concerns addressed by the Department with respect to other kinds of principal transactions. In fact, the vast majority of UIT sales can best be described as "riskless principal" transactions. We note that in footnote 27 to the Proposed Best Interest Contract Exemption, the Department states that: "For purposes of this proposed exemption, however, the Department does not view a riskless principal transaction involving mutual fund shares as an excluded principal transaction."⁶

2. PTE 86-128

The proposed amendment and partial revocation of PTE 86-128 includes a new transaction to the exemption for certain fiduciaries to act as principal (as opposed to agents for third parties) in selling mutual fund shares to plans and IRAs and to receive commissions for doing so.⁷ The "Mutual Fund

⁵ 80 Fed. Reg. at 22018.

⁶ 80 Fed. Reg. at 21968.

⁷ 80 Fed. Reg. at 22022.

Transactions Exemption defines "Mutual Fund" as an open end investment company registered under the Investment Company Act of 1940.⁸ We would request that the Department either clarify that UITs (which technically may be considered "open end investment companies registered under the 1940 Act" but are not "registered open end management investment companies") were intended to be included in this definition or specifically add "unit investment trusts" to this particular transaction exemption by including them in the definition of "Mutual Funds" for purposes of PTE 86-128. We believe the Department intended to exclude closed-end funds, shares of which are not purchased or sold at NAV, plus a commission, by adding the words "open end" to this definition and did not consider the possible exclusion of unit investment trusts.

3. Proposed Class Exemption for Principal Transactions in Certain Debt Securities

As detailed in this letter, the sale of UITs in principal transactions satisfy the concerns addressed by the "General Conditions" in Section III and "Disclosure Requirements" in Section IV of the proposed principal transaction exemption.⁹ In addition, units of UITs are not themselves "debt securities" so a distinct additional exemption to these provisions, similar to the "Mutual Funds Exemption" in PTE 86-128, might be appropriate.

We appreciate the opportunity to provide comments on the Proposed Rules on behalf of our clients, and would be happy to provide any additional information or clarification to the Department that may be necessary for the final regulations.

Respectfully submitted,
PAUL HASTINGS LLP



Michael Rosella



Gary Rawitz

⁸ 80 Fed. Reg. at 22030.

⁹ 80 Fed. Reg. at 22002 - 22003.